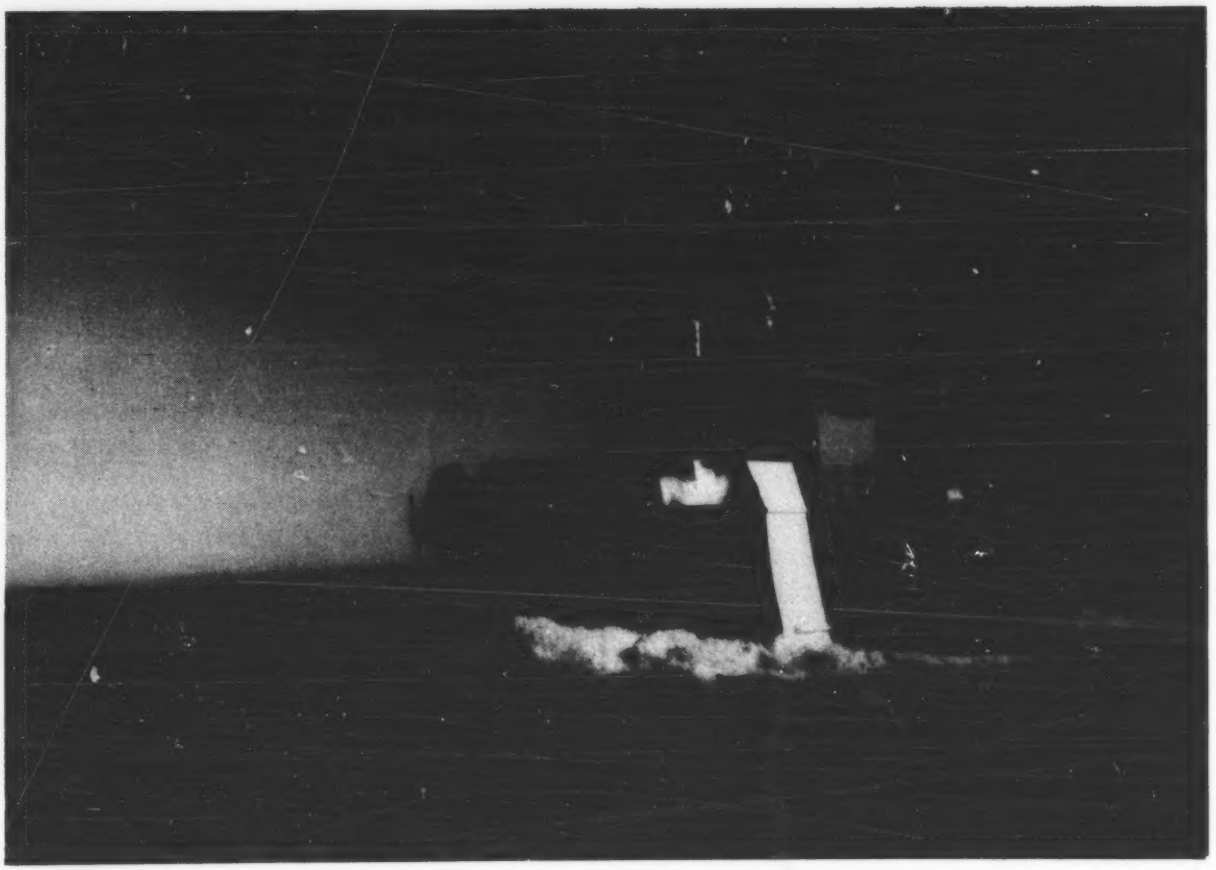
ANNUAL REPORT

MARCH 31, 1987

GEORGETOWN SHIPYARD INC.



CANADIAN COAST GUARD TYPE 200 SEARCH AND RESCUE VESSEL

ANNUAL REPORT GEORGETOWN SHIPYARD INC.

March 31, 1987

Established by an Act of the Provincial Legislature (23 Eliz. II (2) Cap. 71)

Executive Council under authority of Section 12 did order and issue a Proclamation proclaiming the said "Act to Incorporate Georgetown Shipyard Inc." to come into force effective 5 December 1974.

GEORGETOWN SHIPYARD INC.
P.O. Box 220
Georgetown
Prince Edward Island
C0A 1L0

DIRECTORS OF GEORGETOWN SHIPYARD INC.

AS AT MARCH 31, 1987

Keith T.N. Lapp, Chairman

Beverley Simpson, Vice Chairman

Phillip Wood

Carter Van Iderstine

Charles Martell

Cynthia Hickox

Harold Pollard

The Honourable Leonce Bernard
Minister Responsible for Georgetown Shipyard Inc.
P.O. Box 2000
Charlottetown, P.E.I.
C1A 7N8

Sir,

In accordance with the provisions of the "Act to Incorporate Georgetown Shipyard Inc.", we submit the Annual Report of Georgetown Shipyard Inc. for the fiscal year ending March 31, 1987.

The Canadian shipbuilding industry is at the lowest level since the start of keeping accurate records some 25 years ago. The Canadian Shipbuilding and Ship Repair Association reported that the industry's order book at the end of 1986 was only 40,350 Gross Tons down 55% from the previous year and 77% from 1983. The 1986 year end order book consisted of 38,700 GT of federal government orders (96% of total) and only 1650 GT of commercial orders (4% of total). The majority of the orders, with the exception of Canadian Patrol Frigate Program, will be completed and delivered by mid 1987.

Georgetown Shipyard fell into the same pattern as the total industry in Canada. The last new vessels (Hulls 46 and 47), were delivered in December 1986 and the Company was left with no shipbuilding orders at the end of 1986 and was not able to secure a new order by the 31 March 87 fiscal year end.

The outlook for 1987 and beyond appears to have the potential to halt the downward trend. The fishing industry has regained its strength, the offshore oil and gas operations should resume in the next few years, other commerical operators should soon be seeking vessel replacements, and the federal government will continue their plans to upgrade their fleet although at a reduced level compared to the last few years.

The problem with the potential recovery is the federal government's apparent lack of concern about the industry and the lack of desire to retain the economic benefits of the shipbuilding and marine programs in Canada. Other maritime nations, including the USA, have had stringent national policies to safeguard their vital marine industry. Other national governments offer heavy subsidies to attract this business while the Canadian government has eliminated all direct support to the shipbuilding industry.

Georgetown Shipyard's primary market in the next decade will be the fishing industry. There has been a latent demand building up for new fishing vessels over the past few years that is now coming forth as the fishing industry recovers. The Company, however, is facing a situation where fishing vessels over 100 feet can be brought into Canada duty free from heavily subsidized shipyards in foreign countries. The federal government must take action if the industry in Canada is to survive. The fishing industry is harvesting a resource that belongs to all Canadians and should be carried out with Canadian made products. The Company strongly supports the Canadian Shipbuilding and Ship Repair Association's position that a temporary moratorium should be placed on the importation of foreign vessels for domestic use (similar to the USA "Jones Act").

The ship repair market remained at a low level and very competitive in the 1986 repair season. The Georgetown Wharf that was destroyed by fire in August 1983 was replaced but was not available until the fall of 1986, and prevented the Company from bidding on major alongside refits. As stated in previous reports, the total available ship repair market has decreased significantly in recent years as older fishing vessels that could be docked with the Company's existing facilities were retired and replaced with larger vessels.

There was a major accident on the marine railway on 25 August 1986 while hauling a large fishing vessel out of the water. The roller frames came off the track, stranded the vessel and damaged the track and cradle. The Company was covered by liability insurance on the vessel, physical damage insurance on the marine railway, and business interruption insurance. The deductibles were written off to operations in the year but the insurance claims are not reflected in the accounts. The accident put the facility out of commission for the balance of the fiscal year and reduced the ship repair business significantly.

Although the federal government has eliminated all direct grants and subsidies to shipyards, other provinces have circumvented the policy by directing federal funds received through federal-provincial offshore agreements and other special arrangements, to upgrade and modernize the shipyard facilities in their provinces. Georgetown Shipyard has had very few capital improvements carried out since the Company was formed and continues to lose ground to our competition because of obsolete and inadequate facilities. A modernization program must be carried out if the Company is to be successful in the highly competitive market place.

Shipbuilding production consisted of the construction, outfit, trials and delivery of two type 200 Search and Rescue Vessels for the Canadian Coast Guard. The two 80 ft. vessels (Hulls 46 and 47) were accepted by the Crown in St. John's, Newfoundland on 13 December 1986. The ships were named "Hood" and "Harp" and will operate out of northern Newfoundland. Unfortunately, there were no follow-on shipbuilding orders after these hulls which left the shipyard with no new construction in the last four periods of the fiscal year.

Ship repair production started off the fiscal year at a very high level. There was a major contract for Clearwater to convert a herring seiner into a scallop dragger. There were also five dockings and refits of fishing vessels and other miscellaneous repairs. The accident to the marine railway on 25 August 1986 put the facility out of commission and resulted in negligible ship repair production in the last seven months of the fiscal year.

Industrial production which was also down in the year consisted of the assembly of heat exchangers for the Charlottetown district heating systems and other small miscellaneous jobs.

The Union Agreement expired on 28 February 1986. Negotiations were carried out successfully and a new two year agreement was signed on 17 April 1986. The Union membership agreed to defer a March 1987 scheduled wage increase for eleven months to 1 February 1988 in order to make the Company more competitive on the Usen Fisheries new construction prosposal and other contracts. Management-Union relationships remained good.

The financial statements for the fiscal year ending 31st March 1987 showed sales revenue of $5,715,680 and a net loss of $1,511,411. The loss included $173,006 of bank interest expense and $72,153 of depreciation. The deficit was $747,411 over the projected loss of $764,000 that was budgeted at the beginning of the year (March 1986) which arose in part from the decision, with government concurrence, to bid a major shipbuilding project (Hulls 46 and 47) at a reduced overhead rate in order to be more competitive in a very tight market. the excess loss of $747,411 over budget was due mainly to:

— Cost overruns on the Hull 46/47 contract caused primarily by an underbid of manhours.

— A five-month delay in the start of the Hull 46/47 program because of a faulty government design.

— Unabsorbed overhead resulting from the lack of production in the last twenty weeks in the fiscal year after the delivery of Hulls 46 and 47.

The 1987 fiscal year loss of $1.5 million is far from an acceptable result even though half of it was anticipated in order to provide employment at the yard. Steps are being taken to re-organize in order to avoid such an unexpected result in the future, but we are operating in a very depressed industry and with antiquated equipment. We have formulated a limited immediate modernization program and we are encouraged by your government's initial response to it. However, we wish to keep before you our longer term need for a new Ship Lift System in order to compete in future for the larger vessels now required by the fishing industry.

Notwithstanding the 1987 loss, it must be kept in mind that Georgetown Shipyard did contribute $3.9 million to the economy of Prince Edward Island during the fiscal year through $2.5 million in salaries, wages and benefits and $1.4 million in local purchases of material equipment, supplies and service. Furthermore we will be filing a claim against the Crown to recover the costs and damages resulting from the five-month delay in starting the Hull 46/47 contract which was not reflected in the year-end accounts.

The Board of Directors would like to extend our thanks to the tradesmen, staff and management at Georgetown Shipyard for their support and efforts in the operation of the shipyard during the year under review.

Respectfully submitted,

Keith T. Lapp, F.C.A.
Chairman

GEORGETOWN SHIPYARD INC.

FINANCIAL STATEMENTS

FOR THE YEAR ENDED

MARCH 31, 1987

April 29, 1987

AUDITORS' REPORT TO THE BOARD OF DIRECTORS

We have examined the statement of financial position of Georgetown Shipyard Inc. as at March 31, 1987 and the statements of deficit, loss, and changes in financial position and the schedule of expenses for the year then ended. Our examination was made in accordance with generally accepted auditing standards and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, the financial statements and notes appended thereto present fairly the financial position of the corporation as at March 31, 1987 and the results of its operations and changes in its financial position for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Coopers & Lybrand
Chartered Accountants

GEORGETOWN SHIPYARD INC.

STATEMENT OF FINANCIAL POSITION AS AT MARCH 31, 1987

ASSETS

	1987 $	1986 $
CURRENT ASSETS		
Accounts receivable less allowance for doubtful accounts — 1987 - $1,000; 1986 - $1,000 (note 4)	1,151,644	575,114
Inventory of materials	582,468	602,606
Incomplete contracts net — (note 2)	59,494	554,003
Deposits — tender and warranty	104,000	50,000
Prepaid expenses and sundry assets	76,833	88,488
	1,974,439	1,870,211
OTHER ASSETS	64,060	38,245
FIXED ASSETS (note 3)	499,359	565,330
	2,537,858	2,473,786

LIABILITIES

CURRENT LIABILITIES		
Bank advances (note 4)	1,668,886	1,389,287
Accounts payable and accrued liabilities	984,458	1,255,305
	2,653,344	2,644,592
A.D.B. LOAN — WATER SUPPLY SYSTEM	35,303	38,245
NON-INTEREST BEARING ADVANCE FROM THE PROVINCE OF PRINCE EDWARD ISLAND	578,246	578,246
APPRAISAL INCREASE CREDIT (note 3b)	18,376	21,270
	3,285,269	3,282,353
DEFICIT — DUE FROM THE PROVINCE OF PRINCE EDWARD ISLAND	747,411	808,567
	2,537,858	2,473,786

SIGNED ON BEHALF OF THE BOARD

_____

Director

_____

Director

GEORGETOWN SHIPYARD INC.

STATEMENT OF DEFICIT

DUE FROM THE PROVINCE OF PRINCE EDWARD ISLAND

FOR THE YEAR ENDED MARCH 31, 1987

	1987	1986
	$	$
BALANCE — BEGINNING OF YEAR	808,567	688,284
Advances from The Province of Prince Edward Island as payment towards the prior year loss	808,567	688,284
	—	—
Net loss for the year	1,511,411	808,567
Advance from the Province of Prince Edward Island as payment towards current year losses of the Shipyard	764,000	—
BALANCE — END OF YEAR	747,411	808,567

GEORGETOWN SHIPYARD INC.

STATEMENT OF LOSS

FOR THE YEAR ENDED MARCH 31, 1987

	Hull Contracts $	Repair Contracts $	Industrial Contracts $	Total 1987 $	Total 1986 $
BILLINGS					
Made during the year	4,519,332	815,754	137,465	5,472,551	3,803,548
Decrease (increase) in billings made on incomplete contracts					
Opening balances	253,660	—	—	253,660	1,868,524
Closing balances	—	—	10,531	10,531	253,660
	253,660	—	(10,531)	243,129	1,614,864
Net sales — completed contracts	4,772,992	815,754	126,934	5,715,680	5,418,412
COSTS					
Incurred during the year	4,675,704	851,251	145,369	5,672,324	4,500,609
Increase (decrease) in costs incurred on incomplete contracts					
Opening balances	804,836	—	2,827	807,663	2,164,705
Closing balances	—	22,164	47,861	70,025	807,663
	804,836	(22,164)	(45,034)	737,638	1,357,042
Net costs — completed contracts	5,480,540	829,087	100,335	6,409,962	5,857,651
GROSS PROFIT (LOSS) — COMPLETED CONTRACTS	(707,548)	(13,333)	26,599	(694,282)	(439,239)
MISCELLANEOUS INCOME				8,845	6,541
				(685,437)	(432,698)
EXPENSES (schedule)				1,768,780	1,656,226
APPLIED TO NET COSTS — COMPLETED CONTRACTS				942,806	1,280,357
				(825,974)	(375,869)
NET (LOSS) FOR THE YEAR				(1,511,411)	(808,567)

GEORGETOWN SHIPYARD INC.

STATEMENT OF CHANGES IN FINANCIAL POSITION

FOR THE YEAR ENDED MARCH 31, 1987

	1987 $	1986 $
OPERATING ACTIVITIES		
Net (loss) for the year	(1,511,411)	(808,567)
Items not affecting cash		
Depreciation	75,047	79,733
Amortization of appraisal credit	(2,894)	(2,894)
	(1,439,258)	(731,728)
Net (increase) in non-cash working capital balances related to operations	(372,181)	(741,013)
	(1,811,439)	(1,472,741)
FINANCING ACTIVITIES		
Payment received from Province of P.E.I.	1,572,567	688,284
Reduction of A.D.B. loan — water supply	(2,942)	(2,942)
	1,569,625	685,342
INVESTING ACTIVITIES		
Reduction in appraisal credit	(2,894)	(2,894)
(Increase) decrease in other assets	(25,815)	4,898
Purchase of fixed assets — net	(9,076)	(69,621)
	(37,785)	(67,617)
INCREASE IN BANK ADVANCES DURING THE YEAR	279,599	855,016
BANK ADVANCES — BEGINNING OF YEAR	1,389,287	534,271
BANK ADVANCES — END OF YEAR	1,668,886	1,389,287

GEORGETOWN SHIPYARD INC.

SCHEDULE OF EXPENSES

FOR THE YEAR ENDED MARCH 31, 1987

	1987	1986
	$	$
Salaries, wages and benefits	889,914	903,661
Utilities	86,145	132,548
Security	63,756	64,213
Office and postage	23,631	22,043
Repairs and maintenance	109,419	109,609
Advertising and promotion	19,051	19,236
Supplies and small tools	103,902	114,822
Travel	26,855	25,493
Insurance - premiums	44,389	36,243
- deductible portion of loss (note 5 (b))	12,750	—
Taxes	13,317	12,588
Rentals	20,418	16,793
Director fees and expenses	20,541	19,268
Professional fees	59,360	6,555
Bad debts — (recovery)	745	(3,923)
Interest and bank charges	173,006	91,890
Truck expense	9,295	7,170
Inventory adjustment account	3,718	(12,689)
Miscellaneous	16,415	13,867
Depreciation and amortization	72,153	76,839
	1,768,780	1,656,226

GEORGETOWN SHIPYARD INC.

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED MARCH 31, 1987

1. ACCOUNTING POLICIES

Long-term shipbuilding contracts —

The Shipyard follows the completed contract method of accounting for revenues and expenses relating to contracts. Under this method progress billings on incomplete contracts less costs are included as a current liability and costs in excess of progress billings are recorded as a current asset. Income is recorded when a contract has been completed, however, any anticipated or known losses are recorded by way of a provision at the time they are known.

Inventories —

Inventories are valued at the lower of cost and market. Cost is defined as average cost. Market is defined as replacement cost.

Depreciation —

Depreciation of fixed assets is calculated using the straight line method at the annual rates of 4% for land improvements, 4% for steel and block frame buildings, 6 2/3% for wood frame buildings, 12.5% for the launchway, 20% for the machinery and equipment and 10% for the tug.

2. INCOMPLETE CONTRACTS

	Ship Repair	Industrial Contracts	Total 1987	Total 1986
	$	$	$	$
Costs —				
Material	14,907	41,443	56,350	531,877
Labor	3,631	3,038	6,669	159,030
Overhead	3,626	3,380	7,006	116,756
	22,164	47,861	70,025	807,663
Progress billings — Net of federal sales tax	—	10,531	10,531	253,660
COST IN EXCESS OF PROGRESS BILLINGS	22,164	37,330	59,494	554,003

3. FIXED ASSETS

(a) These are classified as follows:

	1987			1986
	Recorded Value	Accumulated Depreciation	Net	Net
	$	$	$	$
Land and improvements	140,847	25,251	115,596	116,687
Buildings	668,209	348,711	319,498	349,072
Launchway	142,828	121,978	20,850	27,481
Machinery and equipment ...	694,650	651,235	43,415	70,740
Tug	27,163	27,163	—	1,350
	1,673,697	1,174,338	499,359	565,330

(b) The land and land improvements, buildings and launchway are recorded at appraised values established January 24, 1974 plus subsequent additions at cost less disposals at the recorded value, excepting the new stores building which is recorded at its actual cost.

The excess appraised value over the original recorded value is $48,240 and the resulting credit is shown as an appraisal increase credit less amortization of $29,864 accumulated to date.

4. SECURITY FOR BANK ADVANCES

Bank advances are secured by guarantees, expiring March 31, 1988 from the Province of Prince Edward Island to the extent of $2,500,000.

5. CONTINGENCIES

(a) During 1985 fiscal year the company was named as defendant in lawsuits arising from a fire in August 1983, at the Georgetown Wharf. Statements of claim have been received by the company. The amount of the claims is covered by liability insurance, of which the deductible portion had been charged to operations in the 1985 fiscal year. To date, no settlement of this matter has taken place and the deductible portion of the liability insurance remains as an accrued liability.

(b) An accident occured August 25, 1986 on the drydocking facility while hauling a vessel out of the water. The Insurance Claim covering physical damage and business interruption insurance was filed and is considered valid by Management, but the Insurance Company has not yet accepted liability. Although the deductible portion of the policy has been charged to operations during the current fiscal year, the corporation has not recorded the amount of the claims in the accounts.